

Message Text

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COME-00 FRB-02 INR-10 NSAE-00 XMB-07 OPIC-12 LAB-06

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DEPARTMENT PASS TREASURY AND FRB

E.O. 11652:N/A

TAGS: ECON, UK

SUBJECT: THE BUDGET MAKING PROCESS IN THE UNITED KINGDOM

REF: (1) A-L34, 2-8-74; (2) A-242, 3-15-74; (3) A-248,
3-18-74

BEGIN SUMMARY: WITH BUDGET DAY A WEEK AWAY, THE MAIN TOPIC OF CONCERN IN THE UK IS THE SHAPE OF THE NEW LABOUR GOVERNMENT'S BUDGET. THERE IS CONSIDERABLE PRESS SPECULATION WHETHER THE NEW CHANCELLOR OF THE EXCHEQUER DENIS HEALEY (THE ECONOMIST MAGAZINE REFERRED TO HIM AS "DENIS THE MENACE" THIS WEEK) WILL (A) BRING IN A DRACONIAN DEFLATIONARY BUDGET EITHER IN THE BELIEF THAT DEMAND DEFLATION IS NEEDED OR AS A RESULT OF MASSIVE TAX INCREASES FOR REDISTRIBUTION OF INCOME, OR (B) WILL ENDEAVOR TO MAKE THE IMPACT OF THE BUDGET NEUTRAL, OR EVEN SLIGHTLY STIMULATORY DESPITE ITS ALMOST CERTAIN REDISTRIBUTIONAL FEATURES.

THIS COULD BE DONE BY LOWERING TAX RATES ON LOWER INCOME

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EARNERS, RAISING THE THRESHOLD AT WHICH TAX IS PAID, OR BY

INCREASING EXPENDITURE TO BALANCE THE TAX RISES. WHAT HEALEY REVEALS ON BUDGET DAY WILL BE DETERMINED BY HIS OWN BELIEF AS TO WHICH WAY THE ECONOMY IS HEADING IN THE NEXT 12 MONTHS, THE POLITICAL DYNAMICS OF THE LABOUR PARTY ITSELF, AND BY THE OPTIONS ON THE BUDGET BEING PUT TO HIM BY THE TREASURY. END SUMMARY

1. AS A GENERAL RULE, UK FISCAL POLICY IS PRESENTED IN TWO PARTS. THE MAJOR ANNUAL EXPENDITURE PROGRAMS AND ESTIMATES, ON A LONG TERM BASIS ARE PUBLISHED IN THE LAST QUARTER OF THE PRECEDING CALENDAR YEAR. (FOR MOST RECENT EXPENDITURE TRENDS, SEE A-248 OF MARCH 18, 1974.) THE FISCAL YEAR ON WHICH TAX LIABILITY IS BASED GENERALLY RUNS FROM APRIL TO MARCH. WHAT IS CALLED "THE BUDGET", THE REVENUE SIDE OF THE FISCAL POLICY WITH INCOME AND CORPORATE TAX FEATURES AND AN ECONOMIC FORECAST, IS PRESENTED TO PARLIAMENT IN ADVANCE OF OR AT THE BEGINNING OF THE NEW FISCAL YEAR, IN MARCH OR APRIL.

2. THE MARCH/APRIL BUDGET IN THE UK IS THE MAJOR GOVERNMENT ECONOMIC PRONOUNCEMENT OF THE YEAR. IN IT, GOVERNMENT FORECASTS OF ECONOMIC ACTIVITY OVER THE NEXT 12 MONTHS ARE REVEALED, AND GOVERNMENT SHORT-TERM ECONOMIC POLICY ON DEMAND MANAGEMENT IS DELINEATED. SINCE PUBLIC EXPENDITURE IS, IN THEORY AT LEAST, BASED ON A LONG-TERM OUTLOOK IN WHICH RESOURCE AVAILABILITIES AND SOCIAL NEEDS PLAY THE PRIMARY ROLE, THE BURDEN OF SHORT-TERM DEMAND MANAGEMENT IS USUALLY ON TAX POLICY AND MONETARY/CREDIT POLICY. THIS DOES NOT EXCLUDE CHANGES IN GROWTH RATES OF PUBLIC EXPENDITURE FOR DEMAND MANAGEMENT, AS THE LAST FEW YEARS HAVE WITNESSED.

3. THE CHANGE OF GOVERNMENT WILL EMPHASIZE THE BUDGET'S IMPORTANCE BECAUSE IT SPELLS OUT CHANGES IN POLICY OF THE PARTY PROGRAMS IN COST TERMS. THE CONSERVATIVE PARTY BUDGETS WERE NOTED FOR THEIR EMPHASIS ON TAX CUTTING, REVISION, AND REFORM, BOTH TO STIMULATE DEMAND IN THE SHORT TERM (THE BRITISH ECONOMY WAS STAGNANT FOR MUCH OF THEIR FIRST TWO YEARS IN OFFICE) AND AS A LONG-TERM POLICY

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OF INDUCING MORE INVESTMENT AND A HIGHER GROWTH RATE. THE LABOUR PARTY BUDGETS WILL PROBABLY BE CHARACTERIZED MORE BY EMPHASIS ON SOCIAL NEEDS AND REDISTRIBUTION OF INCOME THROUGH CHANGING THE TAX STRUCTURE AS WELL AS THROUGH INCREASING TRANSFERS. LABOUR BUDGETS MAY ALSO REFLECT THE THRUST OF PARTY IDEOLOGY TOWARD MORE GOVERNMENT CONTROL AND NATIONALIZATION.

4. THE QUESTIONS FOR THE UPCOMING BUDGET MAY REFLECT BOTH THE LONG AND SHORT-TERM CONSIDERATIONS. IN THE SHORT TERM THE GOVERNMENT MUST DECIDE WHETHER ITS BUDGET SHOULD BE DEFLATIONARY, NEUTRAL, OR STIMULATORY. CHANCELLOR HEALEY CALLED DURING THE ELECTION CAMPAIGN FOR "AUSTERITY" AND IS IDENTIFIED WITH THE SCHOOL OF THOUGHT THAT BELIEVES THAT OUTPUT CONSTRAINTS OF OIL SHORTAGES AND THE RECENTLY ENDED THREE-DAY POWER LIMIT TO INDUSTRY CALL FOR SOME NET REDUCTION OF DEMAND THROUGH HIGHER TAXES AND/OR LESS PUBLIC EXPENDITURE, TO PREVENT EXCESS DEMAND PRESSURES FROM DEVELOPING. HE IS KNOWN TO RELY FOR ADVICE, INTER ALIA, ON THE CAMBRIDGE ECONOMIC POLICY GROUP, SOME OF WHOSE MEMBERS (GODLEY) HAVE CALLED FOR AN EXPANSIONARY BUDGET

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WITH A DEFICIT OF ABOUT 1 BILLION POUNDS. OTHERS OF THIS

GROUP HAVE RECOMMENDED A NEUTRAL BUDGET. THE GROUP GENERALLY BELIEVES IN A LONG-TERM BALANCED BUDGET CONCEPT (SEE A-134 OF FEBRUARY 8, 1974), RELATED IN SOME WAY TO THE CED BUDGET CONCEPT IN THE US OF THE LATE 1940'S.

5. OTHER ECONOMIC JOURNALISTS SUCH AS PETER JAY OF THE TIMES CALL FOR A DEFLATIONARY BUDGET. THE BANK OF ENGLAND IS MORE FEARFUL OF DOMESTIC DEMAND PRESSURES. IT HAS CITED INFLATION AND THE BALANCE OF PAYMENTS AS THE TWO MOST PRESSING LONG-TERM PROBLEMS IN THE ECONOMY, AND CALLED FOR MORE DIVERSION OF DOMESTIC RESOURCES INTO EXPORTS OR IMPORT SUBSTITUTES.

6. OTHER ECONOMIC WRITERS, SUCH AS ANTHONY HARRIS AND SAM BRITTAN, AND THE PRESTIGIOUS NATIONAL INSTITUTE OF ECONOMIC AND SOCIAL RESEARCH, BELIEVE THAT DEMAND WILL BE SEVERELY REDUCED THROUGH THE PUBLIC EXPENDITURE CUTS OF DECEMBER 17, 1973, THE OIL PRICE RISE, AND FISCAL DRAG. THEY CALL FOR A NEUTRAL OR STIMULATORY BUDGET. NIESR RECOMMENDS THAT THE GOVERNMENT BE READY TO REFLATE DEMAND THROUGH TAX CUTS AND/OR INCREASES IN PUBLIC EXPENDITURE IN THE SECOND HALF OF THE YEAR (SEE A-242 OF MARCH 15, 1974). HAROLD LEVER, WHO AS CHANCELLOR OF THE DUCHY OF LANCASTER WILL FUNCTION PRIMARILY AS AN ECONOMIC ADVISER TO HAROLD WILSON, APPEARS FROM PRE-ELECTION PRESS INTERVIEWS TO LEAN TOWARD THE EXPANSIONARY POLICY. AS IS COMMON AND TRADITIONAL, NONE OF THOSE INVOLVED IN THE ACTUAL BUDGET-MAKING PROCESS AND DECISIONS ARE OFFERING EITHER PUBLIC OR PRIVATE COMMENTARY TO ANY PERSONS NOT ACTUALLY IN THE OFFICIAL BUDGET PROCESS.

7. INTERRELATED WITH THIS ARE THE LONG-TERM CONSIDERATIONS OF THE PROGRAM OF THE NEW GOVERNMENT. THESE HAVE IMPLICATIONS ON SHORT-TERM DEMAND MANAGEMENT ALSO. LABOUR MAY CHOOSE TO BRING FORWARD MANY NEW, RELATIVELY NON-CONTROVERSIAL PROGRAMS OF SUBSTANTIAL COST; THE WAY THEY ARE FINANCED WOULD INDICATE THEIR IMPACT ON THE SHORT-RUN. THE MOST LIKELY IN THIS BUDGET ARE FOOD SUBSIDIES, INCREASES IN PENSIONS AND FAMILY ALLOWANCES.

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8. THUS, IN THE ABSTRACT, THE BUDGET MAKING PROCESS HERE

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INVOLVES LONG-TERM PROGRAM CONSIDERATIONS OF THE PARTY IN POWER AND SHORT-TERM DEMAND MANAGEMENT CONSIDERATIONS. ON A DIFFERENT LEVEL IT ALSO INVOLVES THE INTERNAL MACHINERY OF THE UK TREASURY. THE NEW CHANCELLOR IS IMMEDIATELY BRIEFED ON TREASURY FORECASTS OF THE ECONOMY. (THESE ARE REVEALED IN GENERAL TERMS ON BUDGET DAY. THE TREASURY FORECASTING MODEL IS A DEMAND BASED MODEL AND WITH THE NIESR HAS TENDED TO OVER-ESTIMATE FLUCTUATIONS IN GDP IN THE PAST. THUS, WE EXPECT THAT THE TREASURY FORECAST WILL ALSO INDICATE A WEAKENING OF DEMAND IN THE SECOND HALF OF THE YEAR AS DID NIESR--SEE A-242 OF MARCH 15, 1974; THERE ARE INDICATIONS THAT TREASURY'S FORECAST DIFFERS FROM NIESR THIS YEAR, PARTICULARLY ON INVENTORY ACCUMULATION AND MAY NOT SEE AS MUCH DEMAND DEFLATION AS NIESR DOES.) THE NEW CHANCELLOR IS INFORMING HIS TREASURY STAFF OF WHAT THE GOVERNMENT'S PROGRAMS ARE, AND REQUESTING OPTIONS ON HOW THESE CAN BE ACHIEVED. TREASURY STAFF TO SOME DEGREE HAVE ANTICIPATED HIS REQUEST SINCE PARTY PROGRAMS ARE WELL-PUBLICIZED AND DISCUSSED IN THE ELECTION CAMPAIGN. AS IS NORMAL IN THIS KIND OF PROCESS, THE CHANCELLOR THEN RECEIVES CAREFULLY INTEGRATED OPTIONS

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(PUBLIC EXPENDITURE, TAX POLICY, OVERALL ECONOMIC POLICY) FOR HIS BUDGET POLICY. THE CHANCELLOR THEN MUST CHOOSE THE BUDGET OPTIONS. IT IS HISTORICALLY HIS PREROGATIVE TO DO SO, BUT MOST CHANCELLORS KEEP IN CONSTANT CONSULTATION WITH THE PRIME MINISTER AND OTHER CABINET COLLEAGUES ON WHERE CUTS OR INCREASES IN EXPENDITURES OR TAXES WILL BE MADE. THERE IS EVERY INDICATION THAT HEALEY IS DOING THE SAME.

9. HE AND HIS THREE NEW TREASURY MINISTERS (DELL, BARNETT, AND GILBERT) ARE MAKING THE BUDGET THEIR FIRST PRIORITY AND ARE RELATIVELY INACCESSIBLE TO STAFF ON OTHER MATTERS. UNTIL THE BUDGET IS ANNOUNCED ON MARCH 26, HEALEY IS IN A SELF-IMPOSED VERBAL PURDAH. HE HAS NOT PARTICIPATED IN FRONT BENCH DEBATES IN THE NEW PARLIAMENT. AT LAST WEEK'S NATIONAL ECONOMIC DEVELOPMENT ORGANIZATION COUNCIL MEETING, WHICH HE CHAIRS, HE ABSTAINED FROM ANY COMMENTS OF SUBSTANCE ON THE GROUNDS THAT HE IS INVOLVED IN BUDGET PREPARATIONS. WE WILL ALL KNOW MORE NEXT TUESDAY.

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